Constructing Monetary Policy

Read the following scenario and determine what economic condition we are facing. Given that information, formulate a monetary policy to correct the issue. Answers questions 7-9 in complete sentences.

It is Christmas of 2000 and our nation is facing exciting times. The United States just elected a Republican president; this will change the balance of power in Washington and determine who will be the new heads of government agencies. The unemployment is 4% and retail stores can not keep shelves stocked.

1. Draw a generic business cycle. Label the phase in which the scenario is occurring.

2. What economic problem is the economy facing? _____
3. What type of monetary policy did you implement? _____
4. What monetary policy action could the Federal Reserve take to correct the problem?
   a. _____

      or

   b. _____

      or

   c. _____

5. By doing this, the Federal Reserve is trying to _____ the money supply.

6. This type of monetary policy would cause banks to _____ lending to consumers.

7. How does the change in lending in #6 affect the money supply?

8. While the Federal Reserve could change the reserve requirement, explain why the Fed will not change the reserve requirement given the economic conditions the scenario is facing.

9. What effect does this monetary policy have on the overall price level of goods and services in the United States?

10. Draw a Supply and Demand graph for the economy that indicates the price change in #9.

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Read the following scenario and determine what economic condition we are facing. Given that information, formulate a monetary policy to correct the issue. Answer questions 7-9 in complete sentences.

It is October of 2008 and our nation is facing challenging times. The United States is in the midst of a national election that could change which political party controls the government. All three major auto makers are facing bankruptcy and over 30 banks have failed so far this year.

11. Draw a generic business cycle. Label the phase in which the scenario is occurring.

12. What economic problem is the economy facing? _____
13. What type of monetary policy did you implement in #13? _____
14. What monetary policy action could the Federal Reserve take to correct the problem?
    a. _____

       or

    b. _____

       or

    c. _____

15. By doing this, the Federal Reserve is trying to _____ the money supply.

16. This type of monetary policy would cause banks to _____ lending to consumers.

17. How does the change in lending in #16 affect the money supply?

18. While the Federal Reserve could change the reserve requirement, explain why the Fed will not change the reserve requirement given the economic conditions the scenario is facing.

19. What effect does this monetary policy have on the overall price level of goods and services in the United States?

20. Draw a Supply and Demand graph for the economy that indicates the price change in #19.